INDEX

AUTHORITIES CITED

Statutes:

Revenue Act of September 8, 1916, 39 Stat. 756—

Sec. 2, Title I, Part I.

Sec. 2, (a).

Sec. 2, (c).

Act of November 23, 1921, sec. 202 (c) (1) and (2), 42 Stat. c. 134.

Regulations:

Art. 106, Regs. 33, Revised.

Art. 1548, Reg. 45 (Income Tax).

In the Supreme Court of the United States

October Term, 1924

Walter L. Marr, appellant
v.
United States
} No. 236

APPEAL FROM THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

This case is here on appeal from a final judgment of the Court of Claims, dismissing appellant's suit to recover $24,944.12, paid under protest as additional income tax for 1916, with interest thereon from January 7, 1922. The sole question is whether Congress had power under the Sixteenth Amendment to impose the tax in question. Its intention to do so cannot be seriously questioned.

THE FACTS

The facts as found by the Court of Claims may be summarized as follows:

The amount paid by appellant as income tax for the year 1916 included the receipt by appellant and his wife in 1916, as a result of the liquidation of the

General Motors Company *of New Jersey*, of 451 shares of preferred and 2,125 shares of common stock of the General Motors Corporation *of Delaware* (hereinafter called the Delaware Corporation) whose market value (with a small cash payment of $100) at that time was $400,866.57, in exchange for 339 shares of preferred and 425 shares of common stock of the General Motors Company *of New Jersey* (hereinafter called the New Jersey Corporation) for which they had paid when purchased prior to March 1, 1913, the sum of $76,400. This difference of $324,466.51 between the original cost and the value of the new securities obtained in exchange was found by the Treasury Department to be income and taxed accordingly.

Prior to the year 1916 the New Jersey Corporation had outstanding $15,000,000 of 7% preferred stock and $15,000,000 of common stock of the par value of $100 per share. "*It had accumulated a large surplus, and the actual value of its common stock was, at the date of the exchange, $842.50 per share.*" (Rec. p. 5.)

In 1916 the officers of the New Jersey Corporation caused the Delaware Corporation to be organized for the purpose of taking over and continuing the business of the New Jersey Corporation. The authorized capital of the Delaware Corporation was $82,600,000 of common and $20,000,000 of non-voting preferred stock.

The Delaware Corporation, having been organized as aforesaid, offered the shareholders of the New Jersey Corporation the privilege of exchanging their

shares of stock for shares of the Delaware Corporation on the following basis:

(*a*) One and one-third ($1\frac{1}{3}$) shares preferred stock of the Delaware Corporation for one (1) share of preferred stock of the New Jersey Corporation.

(*b*) Five (5) shares of common stock of the Delaware Corporation for one (1) share of common stock of the New Jersey Corporation.

Certificates for fractional shares were not to be issued, but in place thereof the Delaware Corporation agreed to pay in cash at the rate of $100 a share for its preferred stock and $150 a share for its common stock.

The plan of exchange became effective November 1, 1916. It was accepted by all the holders of the common stock of the New Jersey Corporation, and $75,000,000 of the authorized $82,600,000 common stock of the Delaware Corporation was issued for the outstanding common stock of the New Jersey Corporation.

The holders of practically all of the preferred stock of the New Jersey Corporation also accepted the offer. The few shares not exchanged were paid off or redeemed in cash and retired. In exchange for the shares of those who accepted the offer the Delaware Corporation issued its own six per cent preferred stock at the rate of one and a third shares for one share of the preferred stock of the New Jersey Corporation. All fractional shares were paid in cash as provided in the offer previously referred to.

The remaining $7,600,000 of the authorized common stock of the Delaware Corporation, and such part of its authorized $20,000,000 of preferred stock as was not thus issued in exchange for preferred stock of the New Jersey Corporation were either sold or held for sale as additional capital should be desired.

The Delaware Corporation, having thus become the owner of all the outstanding stock of the New Jersey Corporation, caused the latter to be dissolved and all its assets and liabilities to be transferred to the Delaware Corporation.

THE STATUTE

The tax was assessed under the Revenue Act of September 8, 1916, Ch. 463 (39 Stat. 756), the pertinent parts of which are as follows:

> "SEC. 1. (*a*) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income;
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> * * * * *
>
> "(*b*) In addition to the income tax imposed by subdivision (*a*) of this section (herein referred to as the normal tax) there shall be levied, assessed, collected, and paid upon the total net income of every individual, * * * an additional income tax (herein referred to as the additional tax) of one per centum per

annum upon the amount of which such total net income exceeds $20,000 and does not exceed $40,000 * * * (and further additional tax graduated according to the amount of net income).

"For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, * * *

"All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

"(*c*) The foregoing normal and additional tax rates shall apply to the entire net income except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

* * * * *

"Sec. 2. (*a*) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, *businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property,* also from

interest, rent, *dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: Provided,* That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, *whether in cash or in stock of the corporation,* joint-stock company, association, or insurance company, *which stock dividend* shall be considered income to the amount of its cash value. * * *

"(*c*) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived." (Italics ours.)

ARGUMENT

I

Surplus of the New Jersey Corporation was distributed to its stockholders in the stock of the Delaware Corporation and cash

In limine, it must be borne in mind throughout the argument *that this case involves no question of statutory construction.* Congress meant to exercise

to the limit its power under the Sixteenth Amendment. It meant to tax every conceivable kind of gain that was in a constitutional sense income. *It meant to tax stock dividends.* It said so in so many words. If the New Jersey Company had simply recapitalized itself by a stock dividend similar in amount to the stock of a new company received in exchange, Congress clearly said that such stock dividend should be taxed. This court, however, held that in that respect it had exceeded its power. (*Eisner* v. *Macomber*, 252 U. S. 189.) The Government, of course, accepts that decision as final. That does not alter the fact, however, that Congress intended to impose such tax, whether the stockholder received his share of accumulated surplus in new stock of an *old* company or new stock in a *new* company. Congress clearly intended to tax the profit realized by Mr. Marr on his General Motors stock. Unless that intent was beyond a reasonable doubt in excess of its constitutional powers, it is the duty of the courts to give it effect. (*Ogden* v. *Saunders*, 12 Wheat. 213, 270.) The question is not, therefore, one of statutory construction, but rather whether the clear intent of Congress is to be nullified as not within the sweeping grant of power of the Sixteenth Amendment, which says "from whatever source derived."

At the time of the exchange of stock referred to the New Jersey Corporation had accumulated a large surplus, so that its common stock had a book value and actual value of $842.50 a share, and its preferred

stock had an actual value of at least $100 a share. Therefore, at the time of the exchange of stock the par value and actual value of the stock of the two corporations were as follows:

The New Jersey Corporation

	Par value	Actual value
150,000 shares 7% preferred	$15,000,000.00	$18,937,500.00
150,000 shares common	15,000,000.00	126,375,000.00
Total	30,000,000.00	145,312,500.00

The Delaware Corporation

	Par value	Actual value
200,000 shares 6% preferred	$20,000,000.00	$18,937,500.00
826,000 shares common	82,600,000.00	139,181,000.00
Total	102,600,000.00	158,118,500.00

N. B.—The difference in actual value of the stock of the two corporations is due to the authorization of 76,000 more shares of common stock of the Delaware Corporation than were needed to make the exchange; 76,000 shares at $168.50 a share equals $12,806,000, the amount of the difference.

It is apparent, therefore, that the New Jersey Corporation had on hand about $115,000,000 available for distribution among its stockholders without impairment of capital. As a result of the exchange of stock each stockholder received his share of such surplus and a return of his capital investment in the form of stock of another corporation, together with cash for fractional shares, and the original corporation was then dissolved. Whatever the transaction by which the stockholders received their profits may be called, whether a "dividend," "liquidating dividend,"

or "sale of capital assets," the result was the distribution among the stockholders of the New Jersey Corporation of its accumulated profits, in a form whereby it was readily separable from the amount originally invested in the stock. The fact that the stockholder received his share of accumulated surplus in shares of stock of another company is unimportant. (See *Peabody* v. *Eisner,* 247 U. S. 347.) The stockholder could sell his stock in the market and immediately "cash in" his great gain over his original investment.

This case can not be distinguished from that of *Cullinan* v. *Walker,* 262 U. S. 134, in which, under very similar circumstances, this court held that the taxpayer realized taxable income in the form of a liquidating dividend. Other cases, not distinguishable in principle from the instant case, are *Peabody* v. *Eisner,* 247 U. S. 347; *Goodrich* v. *Edwards,* 255 U. S. 527; *Brewster* v. *Walsh,* 255 U. S. 536; *United States* v. *Phellis,* 257 U. S. 156; and *Rockefeller* v. *United States,* 257 U. S. 176.

As in the case of the *Du Pont Company* (Phellis case), the *Ohio Oil Co.* and the *Prairie Oil & Gas Co.* (Rockefeller case), and the *Farmers' Petroleum Co.* (Cullinan case), *a large surplus had been accumulated by the old corporation which was distributed to its stockholders in the course of a reorganization.* No disregard of corporate entities can obscure this fact. So it was in the case at bar.

That large gains have accrued to appellant's investment in the stock of the New Jersey

> Company is, of course, true. But the question is whether when, in 1916, he exchanged for certificates of the Delaware corporation he received these gains in the form of income. (Appellant's brief, p. 4.)

The learned counsel for appellant correctly states the question, but he disregards the separate corporate entities in order to classify the transaction as in effect a stock dividend, which it was not. It was the distribution of surplus in the form of stock of *another corporation,* as in *Peabody* v. *Eisner,* 247 U. S. 347; *United States* v. *Phellis,* 257 U. S. 156; *Rockefeller* v. *United States,* 257 U. S. 176; and *Cullinan* v. *Walker,* 262 U. S. 134, the only possible distinction being that there was not a distribution of dividends as such, but the stockholders' gains came to them as a result of the exchange of the stock of the old corporation for the stock of the new corporation. However, as stated by Mr. Justice McReynolds in *Weiss* v. *Stearn,* 265 U. S. 242, 254:

> When applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form.

In determining whether a particular transaction is subject to tax, the decisions of this court hold that the substance, and not the form, is to be regarded. In *United States* v. *Phellis,* 257 U. S. 156, the court said:

> We recognize the importance of regarding matters of substance and disregarding forms in applying the provisions of the Sixteenth

Amendment and income tax laws enacted thereunder. In a number of cases besides those just cited we have under varying conditions followed the rule. (*Lynch* v. *Turrish*, 247 U. S. 221; *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71.)

The question whether income was received is to be determined from the result to and effect upo the individual stockholder. In the case of *United States* v. *Phellis, supra,* this court said:

> But further, it would be erroneous, we think, to test the question whether an individual stockholder derived income in the true and substantial sense through receiving a part in the distribution of the new shares by regarding alone the general effect of the reorganization upon an aggregate body of stockholders. The liability of a stockholder to pay an individual income tax must be tested by the effect of the transaction upon the individual (p. 174).

The case at bar does not differ in substance from that of *Peabody* v. *Eisner*, 247 U. S. 347, where the Union Pacific Ry. Co. distributed surplus in the form of stock of the Baltimore & Ohio R. R. Co.; from *United States* v. *Phellis*, 257 U. S. 156, where the Du Pont Company of New Jersey distributed surplus in the form of stock of the Du Pont Company of Delaware; from *Rockefeller* v. *United States*, 257 U. S. 176, where the Ohio Oil Co. and the Prairie Oil & Gas Co. distributed surplus in the form of stock of the Illinois

Pipe Line Co. and the Prairie Pipe Line Co. (the distribution of the stock of the Illinois Pipe Line Co. was made by the vendee corporation rather than by the vendor corporation, and in this respect it is exactly like the case at bar and unlike the Du Pont and Ohio Oil Co. reorganizations); and from *Cullinan* v. *Walker*, 262 U. S. 134, where the surplus of the Farmers' Petroleum Co. was distributed to its stockholders by trustees in dissolution in the form of stock and bonds of the American Republics Corporation, the Republic Production Co., and the American Petroleum Co. In each of these cases, although different methods were employed, *surplus was distributed.*

In the latter case, *Cullinan* v. *Walker*, both surplus and capital were distributed without the formal declaration of a "dividend," either ordinary or liquidating. The distribution was made by the trustees in liquidation, and consisted of stock of the new holding company and bonds of its two operating subsidiaries which took over the assets of the original company. This court held, however, that the difference between the value of the securities so received by the stockholder and the amount of his investment was taxable as income under the Revenue Act of September 8, 1916; and that "gain, which when segregated becomes legally income subject to the tax, may be segregated by a dividend in liquidation, as well as by the ordinary dividend." (*Cullinan* v. *Walker*, 262 U. S. 134, 137.)

The only difference between *Cullinan* v. *Walker* and the case at bar is that in the *Cullinan case* the distribution was made by the trustees in liquidation, while in this case it was made by the new corporation. This difference, however, is immaterial in determining the question whether income accrued to the stockholder as a result of the distribution, for had the distribution in the *Cullinan case* been made by the new holding company rather than by the trustees in liquidation the decision of this court would have been the same—that it was a liquidating dividend, segregating gain from capital, and the gain was taxable as income.

II

The decision of this court in Cullinan v. Walker, supra, rules this case

In *Cullinan* v. *Walker*, a Texas petroleum corporation organized in 1914, with a capital stock of $30,000 (which was increased to $100,000 in 1915), *having accumulated a large surplus*, was *reorganized* for the purpose of separating its business of production from its business of transportation of oil, *as in the Rockefeller case*, in order to comply with the laws of the State in which it was organized.

The plan of *reorganization* formulated by the stockholders and directors contemplated the organization of three new corporations—two corporations, one a producing and the other a pipe line company, to be organized under the laws of Texas; and the third, a holding company, to be organized under the

laws of Delaware. Pursuant to this plan of reorganization the old corporation (Farmers' Petroleum Co.) was dissolved and the assets held and business continued by the trustees. The trustees then organized two operating companies under the laws of Texas: (1) Republic Production Company, a producing company; and (2) American Petroleum Co., a pipe line company, and transferred the production assets to the first company and the transportation assets to the second. The properties so transferred were all the assets of the old Farmers' Petroleum Company and constituted the sole assets of the newly organized companies.

Each of the new Texas corporations issued upon organization $1,500,000 in capital stock and a like amount in gold debenture bonds, which stock and bonds, upon their issuance, were delivered to the trustees, pending the consummation of the reorganization.

As the third step in the plan of reorganization, a corporation, the American Republics Corporation, was incorporated by said Trustees, under the laws of Delaware, to exist in the capacity solely of a holding company of the stocks of the Republic Production Co. and the American Petroleum Co. The holding company then received from the Trustees all of the stock, aggregating $3,000,000 par value, of the Republic Production Co. and the American Petroleum Co., such stocks constituting its entire capital and only assets. The holding company thereupon issued

and delivered its stock in the amount of $3,000,000 par value, consisting of 30,000 fully paid shares each of the par value of $100, to the Trustees. The stock of the holding company and the bonds of the two new Texas corporations were thereupon distributed by the Trustees among the stockholders of the Farmers' Petroleum Co. in proportion to their respective stock ownership in the latter corporation.

At the time of the distribution of these stocks and bonds the American Petroleum Co. and Republic Production Co. had no assets other than those transferred to them by the Trustees in liquidation of the Farmers' Petroleum Co., and the assets so transferred had the same value at the time of such distribution as when held by the Trustees of the Farmers' Petroleum Co.

At and during the period of reorganization and for a long time prior thereto Cullinan owned in his own right 266.4 shares of the capital stock of the Farmers' Petroleum Co. (which had cost him $26,640), the same representing 26.64% of the entire capital stock of the latter company, and he received the same percentage of the bonds of the Republic Production Co. and the American Petroleum Co. and stock of the American Republics Corporation as a result of the reorganization. The tax was assessed upon the difference between the capital invested by him and the value of the securities received, the value of the securities so received being $1,598,400, from which was deducted his capital investment of $26,640, leaving a gain of $1,571,760, which was taxed as income.

Cullinan contended, as does the appellant, that the securities issued to him were *in toto* capital, and not income; that they came to him merely as an incident of reorganization; that there was no segregation of gain from capital; and that what he received was, in legal effect, a stock dividend under *Eisner* v. *Macomber*, 252 U. S. 189. This court, however, in denying Cullinan's contention, said:

> Cullinan insists that his gain so ascertained was *merely an incident of a reorganization. This was equally true in the Phellis and the Rockefeller cases.* It is sought to differentiate those cases on the ground that there the distributed stock of the new corporation was technically a dividend paid out of surplus, and that here the segregation is not of that character. *But the gain, which when segregated becomes legally income subject to the tax, may be segregated by a dividend in liquidation, as well as by the ordinary dividend.* If the trustees in liquidation had sold all the assets for $6,000,000 in cash, and had distributed all of that, no one would question that the late stockholders of Farmers' Petroleum Company would in the aggregate have received a gain of $5,900,000 taxable as income. The result would obviously have been the same if the trustees had taken in payment and distributed bonds of the value of $6,000,000 in some new corporations. And the result must also be the same where that taken in payment is $3,000,000 of such bonds and $3,000,000 in stock of a third corporation. *All the material elements which*

differentiate the Phellis and Rockefeller cases from Eisner v. *Macomber are present also here.* The corporation whose stock the trustees distributed was a holding company. In this respect it differed from Farmers' Petroleum Company, which was a producing and pipe-line company. *It differed from the latter, also, because it was organized under the laws of another state.* It is true that at the time this Delaware corporation's stock was distributed it held the stock of the new oil-producing company and likewise the stock of the new pipe-line company. But the Delaware corporation was a holding company. It was free at any time to sell the whole or any part of the stock in either of the new Texas companies and to invest the proceeds otherwise. By such a sale and the change of investments all interest of the holding company in the original enterprise might be parted with without in any way affecting the rights of its own stockholders. *When the trustees in liquidation distributed the securities in the three new corporations, Cullinan, in a legal sense, realized his gain, and became taxable on it as income for the year 1916* (p. 496). (Italics mine.)

Can there be any doubt that the decision of the court would have been the same had the distribution been entirely in the *stock* of another corporation, organized under the laws of another state, as in the case at bar, and as it was in the *Phellis* and *Rockefeller cases?* Obviously not, for, as stated by the court, "All the material elements which differentiate the

Phellis and *Rockefeller cases* from *Eisner* v. *Macomber*, are present also here." (*Cullinan Case*, p. 496.) So are they present in the case at bar. If there is any noteworthy distinction it is in the fact that the distributions of stock in the *Phellis* and *Rockefeller cases* were made by the old corporations rather than by the new corporations. But this distinction is one of form only; and "when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form." (*Weiss* v. *Stearn*, 265 U. S. 242, 254.)

It must be remembered that the main contentions of the appellant in the case at bar—i. e., that there was no realization of gain or income—there was no *segregation* of income from capital; and that no income was *derived from* the capital invested were also the contentions of the stockholders in the *Phellis*, *Rockefeller* and *Cullinan cases*. These contentions have been fully answered by this Court in its decisions in those cases. The following quotation from the opinion of the court in the *Phellis case* (257 U. S. 156, 175) is directly in point:

> According to the findings the stock thus distributed was marketable. There was neither express nor implied condition, arising out of the plan of reorganization or otherwise, to prevent any stockholder from selling it; and he could sell his entire portion or any of it without parting with his capital interest in the parent company, or affecting his propor-

> tionate relation to the interests of other stockholders. Whether he sold the new stock for money or retained it in preference, in either case when he received it he received as his separate property a part of the accumulated profits of the old company in which previously he had only a potential and contingent interest.
>
> It thus appears that in substance and fact, as well as in appearance, the dividend received by claimant was a gain, a profit, derived from his capital interest in the old company, not in liquidation of the capital but in distribution of accumulated profits of the company; something of exchangeable value produced by and proceeding from his investment therein, severed from it, and drawn by him for his separate use. Hence, it constituted individual income within the meaning of the income tax law, as clearly as was the case in *Peabody* v. *Eisner*, 247 U. S. 347.

The same could be said of the case at bar, except that in the *Phellis case* the old corporation continued for a while as a going concern and only surplus was distributed, while in the case at bar the old corporation was dissolved and both capital and surplus distributed, as in the *Cullinan case.*

Now, while the distributions in the *Phellis, Rockefeller,* and *Peabody cases,* though in corporate stock rather than cash, were from accumulated profits, or surplus, and were held taxable by the court as ordinary dividends, the distribution in the *Cullinan case* comprised both capital and profits, or surplus,

and was a *liquidating dividend.* There is much in the decisions of the court in the *Phellis, Rockefeller,* and *Peabody cases* that is helpful in arriving at a correct decision in the case at bar, but the decision of the Supreme Court in the *Cullinan case* is controlling. *It decides the exact issue involved here.* That issue is whether stock of a new corporation received in exchange for the stock of an old corporation by the stockholders of the old corporation, in a transaction resulting in the liquidation of the old corporation and the taking over of its assets by the new corporation, constitutes income to the distributees to the amount of the difference between the cost of the old stock and the fair market value of the new stock. This, I say, was the identical question before the court in the *Cullinan case,* and the court answered it in the affirmative. The two cases are indistinguishable.

In the light of the decisions in the *Phellis, Rockefeller,* and *Cullinan cases* the contention of appellant that there was no realization of income through the separation of gain from capital is untenable. The facts show that the value of one share of the Delaware Company common stock was greater than the amount paid for one share of the New Jersey Company common stock. Appellant paid $100 a share for his stock in the New Jersey Company. He exchanged each share of the New Jersey Company common stock for five shares of the Delaware Company common stock valued at $168.50 each, or an

aggregate value of $842.50. The difference between $100 and $842.50, was gain or income derived from capital. This was the realization of taxable income within the meaning of the Sixteenth Amendment and the Revenue Act of 1916 unless the Court is prepared to overrule the carefully considered decisions in *Cullinan* v. *Walker*, 262 U. S. 134; *Phellis* v. *United States*, 257 U. S. 156; *United States* v. *Rockefeller*, 257 U. S. 176.

III

The distribution was not a stock dividend

Counsel for appellant argues that the stock of the Delaware Corporation received in exchange for stock of the New Jersey Corporation was a stock dividend, or was so closely analogous thereto that it should be exempt from tax as income under *Towne* v. *Eisner*, 245 U. S. 418, and *Eisner* v. *Macomber*, 252 U. S. 189. He says:

> The principle is the same, of course, when he surrenders one certificate and receives others in exchange evidencing the same property interest—his capital with its accrued but unsevered gains. (Appellant's brief, p. 5.)

But he entirely ignores the prime essential of a stock dividend—*it must* be in the stock of the corporation declaring it. *Eisner* v. *Macomber*, *supra*. Otherwise the distributions in the *Phellis*, *Rockefeller*, *Peabody*, and *Cullinan cases* might have all been stock dividends.

If a corporation distributes its surplus or profits in the stock of another corporation without liquidating, such distribution is taxable as income to the stockholders and is not a stock dividend. It is a property dividend. (*United States* v. *Phellis,* 257 U. S. 156; *Rockefeller* v. *United States,* 257 U. S. 176; *Peabody* v. *Eisner,* 247 U. S. 347.) But where a corporation is dissolved and its assets or their value are distributed to its stockholders in the form of stock of the corporation taking over the assets, or their equivalent, the distribution is a liquidating dividend and to the extent that it results in a gain over the original investment, it is taxable as income to the stockholders. (*Cullinan* v. *Walker,* 262 U. S. 134.)

The *Macomber case* clearly shows that the stock distribution in the case at bar was not a stock dividend, and bore little or no analogy to a stock dividend, but to make the difference more apparent I will point out some of the distinguishing features:

(1) A stock dividend is a distribution of the earnings or profits of a corporation in its *own* stock, without diminishing the number of shares of the old stock held by the stockholder. In the case at bar the distribution was in the stock of a new, separate, and distinct corporation, organized under the laws of another state. It consisted of a distribution of surplus of the New Jersey Corporation in addition to the stockholders' capital investment therein, and was effective only upon the surrender by the stockholders of their shares of stock in the New Jersey Corporation

for stock of the separate and distinct legal entity—the Delaware Corporation.

(2) A stock dividend has none of the characteristics of a liquidating dividend. It results from a conversion of surplus or undivided profits into capital stock, which is distributed to stockholders in proportion to their stockholdings, in lieu of a cash dividend. Of its very nature it implies a continuation of the corporation as a going concern. The distribution in the case at bar resulted from the taking over by the Delaware Corporation of all the assets and subsequent dissolution of the New Jersey Corporation.

(3) "A stock dividend really takes nothing from the property of the corporation and adds nothing to the interests of the shareholders. Its property is not diminished and their interests are not increased * * *." (*Eisner* v. *Macomber*, *supra*.) In the case at bar the transaction involving the distribution of stock of the Delaware Corporation for the stock of the New Jersey Corporation took from the latter corporation all the assets it had, transferred them to *another* corporation and the stockholders of the old company only received shares in the new corporation. The assets consisted in large part of accumulated surplus. The realization by the stockholders of these earnings on their original stock could not have been more complete had the distribution been made to them in cash, or in stock and bonds as in the *Cullinan case*.

(4) On the distribution of a stock dividend the proportional interest of each stockholder remains the

same, and the only change is in the evidence which represents that interest. (*Eisner* v. *Macomber, supra.*) In the case at bar the proportional interest of the stockholders was different after the distribution from what it was before. Before the distribution each share of common stock represented 1/150,000 interest in the assets of the New Jersey Corporation; after the distribution each share of the common stock represented 1/826,000 interest in the assets of the Delaware Corporation. Not only did the proportional interest of the shareholder change *but the very nature of the investment also changed*, and he found himself after the distribution no longer a shareholder of the New Jersey Corporation, but a shareholder of another corporation organized under the laws of *another* state, with a larger capital stock and different rights and responsibilities.

(5) "The essential and controlling fact" (that distinguishes a stock dividend) "is that the stockholder has received nothing out of the company's assets for his separate use and benefit." (*Eisner* v. *Macomber, supra.*) In the case at bar the appellant received his pro rata distribution of the assets of the New Jersey Corporation in the form of the stock of the Delaware Corporation. This stock he received for his separate use and benefit and as the purchase price of his interest in the New Jersey Corporation, the assets of which were taken over by the Delaware Corporation. It is immaterial that he received the distribution in stock rather than cash. The stock had a ready market, and was the equivalent of cash to

the amount of its fair market value. (*United States* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *United States*, 257 U. S. 176; *Peabody* v. *Eisner*, 247 U. S. 347; *Cullinan* v. *Walker*, 262 U. S. 134.)

(6) Unlike the case where surplus is added to capital and new shares issued to the stockholders as a stock dividend, the exchange by the appellant of his shares of stock in the old corporation for shares in the new was a *voluntary act*. Where a corporation by appropriate proceedings increases its capital and distributes the new stock to its old stockholders, they have no option but to accept. Their acceptance does not involve any *voluntary exchange* by them of their old shares for any different property whatsoever or a withdrawal of their investment in the old company.

In the instant case appellant had the proposal made to him to exchange his shares in the New Jersey company for a larger number of shares in the Delaware company. He was at liberty either to accept or reject the proposition. He could have rejected it and insisted upon his right as a stockholder of the New Jersey Corporation to his distributive share of the assets, or an equivalent in cash or other property, upon the dissolution and liquidation thereof. But he chose to accept the proposition offered by the Delaware Corporation, thereby voluntarily exchanging his stock in the New Jersey company for stock in the Delaware company. In so doing he abandoned his business venture as a stockholder in

the old corporation, received back his capital investment, together with its accumulated earnings, which he immediately reinvested in the capital stock of another corporation. Such, in legal effect, was the substance of the transaction. It was a complete, voluntary exchange, and appellant's gain was as definitely realized as though he had received $842.60 cash for each share of stock in the old corporation and immediately reinvested the entire amount received, representing both capital and surplus, in shares of stock of another corporation, or exchanged his old stock for any other property having a ready market.

Thus, from every point of view, the conclusion is inescapable that the distribution here involved was not a stock dividend and was not sufficiently analogous to a stock dividend to escape taxation under the decision of the court in the *Macomber case.*

IV

Weiss v. Stearn, 265 U. S. 242, distinguished

Appellant rests his case almost entirely upon the decision of this court in *Weiss* v. *Stearn, supra. Weiss* v. *Stearn,* did not overrule the preceding cases and was obviously decided on its own peculiar facts, which were stated by this court in its opinion, as follows:

> (A) Respondents and other owners delivered duly indorsed certificates representing the entire capital stock ($5,000,000) of the National Acme Manufacturing Company, incorporated under laws of Ohio—the old cor-

poration—to the Cleveland Trust Company, as depositary. Messrs. Eastman, Dillon & Company deposited $7,500,000 with the same Trust Company. Representatives of both classes of depositors thereupon incorporated in Ohio the National Acme Company—the new corporation—with $25,000,000 authorized capital stock and powers similar to those of the old corporation. Pursuing the definite purpose for which it was organized, the new corporation purchased and took over the entire property, assets, and business of the old one, assuming all outstanding contracts and liabilities, and in payment therefor issued to the Trust Company its entire authorized capital stock. It continued to operate the acquired business under the former management, and the old corporation was dissolved.

(B) The Trust Company delivered to Eastman, Dillon & Company certificates for half the new stock—$12,500,000. To the owners of the old stock—to each his pro rata part—it delivered certificates representing the remaining half, together with the $7,500,000 cash received from Eastman, Dillon & Company. The owner of each $100 of old stock thus received $150 cash, also $250 of new stock, representing an interest in the property and business half as large as he had before. Prior to the specified transactions his interest in the enterprise was 100/5,000,000; thereafter it became 250/25,000,000, or 50/5,000,000. (*Weiss* v. *Stearn*, 265 U. S. 251, 252.)

The Commissioner of Internal Revenue held that as a result of the transaction each old stockholder

sold his entire holdings for cash and stock of the new corporation, and assessed income taxes against them according to the resulting profits. Adopting a different view, this court and the court below held that the old stockholders "really sold half their stock for cash and exchanged the remainder, without gain, for the same proportionate interest in the transferred corporate assets and business." (*Weiss* v. *Stearn*, 265 U. S. 242, 252.)

The court, in *Weiss* v. *Stearn*, distinguished the *Phellis* and *Rockefeller cases* on the ground that in those cases certain corporate assets not exceeding accumulated surplus were segregated and passed to individual stockholders, and the *Cullinan case* on the ground that Cullinan's gain resulted from a dividend in liquidation actually distributed in the stock of a holding company incorporated *under the laws of a foreign state*, not organized for the purpose of carrying on the old business, and which held no title to the original assets. The court held in *Weiss* v. *Stearn* that, excluding the cash, which was properly taxed, the transaction was the same as though the old company had increased its stock to $25,000,000 and then declared a stock dividend of 400%, and that, "considering the entire arrangement, we think it amounted to a financial reorganization under which each old stockholder retained half of his interest and disposed of the remainder." (*Weiss* v. *Stearn*, 265 U. S. 242, 254.)

Possibly some, but certainly not all, of the facts which caused the court to distinguish *Weiss* v. *Stearn*

from the *Phellis, Rockefeller,* and *Cullinan cases* are present in the case at bar. The outstanding differences are, in the instant case:

(1) The new corporation was organized under the laws of a foreign State.

(2) The stockholders' proportional interest in the new corporation was different from their proportional interest in the old corporation.

not gain

(3) What was done could not have been accomplished by an increase in the capital stock of the old corporation and the declaration of a stock dividend.

(4) There was no sale of any part of the old stock for cash, except fractional shares of $100 value, but the exchange was stock for stock, so that all, or none, of the profits must be taxed.

That the foregoing are material points of difference can be demonstrated:

(1) Having regard to the substance of the transaction rather than its form, it is material that the new corporation was organized under the laws of a different State. The materiality of this point was emphasized by this court in the *Phellis case,* in which Mr. Justice Pitney said:

> The plan as thus proposed and adopted and as carried out involved the formation of a *new corporation* to take over the business and the business assets of the old; it was to be and was formed under the laws of a *different State,* which necessarily imports a different measure of responsibility to the public and presumably different rights between stockholders and com-

in the exchange of stock for stock, the proportional interest of the stockholder was the same before as after the reorganization.

(3) Having regard to substance rather than form, the court in *Weiss* v. *Stearn* said that what was actually accomplished might have been accomplished by increasing the capital stock of the old corporation to $25,000,000 and then declaring a stock dividend of 400%, in which event, the court said, "the stockholders would have received no gain—their proportionate interest would have remained the same as before." (*Weiss* v. *Stearn*, 265 U. S. 242, 253.) Manifestly this could not have been done in the instant case because the purpose intended and actually accomplished was the organization of a new corporation *under the laws of another State*. Besides, the proportional interest of the stockholders was destroyed by the reorganization as effected.

(4) *Weiss* v. *Stearn* involved what might be regarded as two separate and distinct transactions, in so far as the individual stockholder was concerned: (*a*) The sale of half his shares of stock for cash, and (*b*) the exchange of the remaining shares for shares of the new corporation. The court held that the stockholder was properly taxed on his profit from the sale, but that no further tax should be exacted on account of the alleged gain from the exchange of shares, for reasons hereinbefore cited. The instant case is unlike the *Weiss* v. *Stearn case* in this respect, but is like the *Phellis* and *Rockefeller cases*, where the stockholders realized their gains in the form of stock

of the new corporations, and the *Cullinan case* where they realized their gains in the form of stock and bonds of the new corporations.

In view of the foregoing points of difference it is submitted that the case at bar is not ruled by the decision of the court in *Weiss* v. *Stearn*, which case was decided on its own peculiar facts; but, on the contrary, the appellant's gain, derived as a result of the reorganization, was clearly taxable under the principles upon which the *Cullinan case* was decided.

If *Weiss* v. *Stearn* is indistinguishable in its essential facts from the instant case, it is in that event equally indistinguishable from the *Phellis*, *Rockefeller*, and *Cullinan cases*, and in that event the court must decide between a rule that was established in a line of cases and a decision in a single case rendered late in a term of court, and apparently with no intention of disturbing the existing rule of law as established by such preceding cases

Let me recall to the Court the origin of the rule and exactly what this Court has decided. In 1916 when this country was drifting into the greatest war that the world has ever known and was straining its resources to the utmost to prepare, Congress passed the act in question, which levied a tax upon "the entire net income received in the preceding calendar year from all sources by every individual." It then proceeded to define income as "gains, profits, and income derived from * * * businesses, trade, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or

When the succeeding cases arose (as Phellis, Rockefeller, and Cullinan), the question still remained one of *power* under the Constitution and not of legislative intention. Remembering that this Court has always held that every possible presumption is in favor of the validity of a statute, and that this continues until the contrary is shown "beyond a rational doubt" (*Sinking Fund cases*, 99 U. S. 700), and that its invalidity should not be adjudged unless it "is too clear to admit of dispute" (*Henderson Bridge Co.* v. *Henderson City*, 173 U. S. 592), this Court held that when a corporation, directly or indirectly, as a going concern or in process of liquidation, distributes the securities of *another* corporation to its stockholders, which distribution, in whole or in part, represents accumulated profits, that it can not be said that Congress was without *power* to impose such a tax, and this notwithstanding the fact, as appeared in those cases, that the change of securities was a method of *reorganization* and that the same men who owned the old corporation controlled the new corporation and with the same proportionate interests.

It can not be argued that these latter cases were not equally within the *intenion* of Congress, for if Congress intended to tax a shareholder of a corporation who received additional stock in *that* corporation, it must have intended the same result when such stockholder accepts, not additional stock in his corporation, but *new* shares of stock in another corporation.

For this reason this Court declined to say that Congress could not lawfully impose a tax when a stockholder of corporation A accepts in lieu of his share of the profits of that corporation shares of stock in corporation B.

For this conclusion there was a very important reason, to which little attention has been called. The stockholder of corporation A who gets a true stock dividend has no choice in the matter. The managing body determine that for one certificate of that corporation he shall accept as an evidence of his proportionate interest a greater number of identical certificates.

When, however, he exchanges his securities in corporation A for securities in corporation B his gain is purely *voluntary*. It is a business transaction which he is free to accept or reject. If he does not want the shares of corporation B he can decline to take them; and if a majority of corporation A desire to liquidate it, they can not do so without giving him his aliquot share of the assets, both capital and surplus, of corporation A.

When purely as a business venture he *voluntarily* elects to take the securities of corporation B in satisfaction of his interest in the capital and accumulated surplus of corporation A, and the securities of corporation B represent his interest in the capital and surplus of corporation A, he has realized his gain, and indubitably Congress intended to tax the transaction so far as it was a gain.

"Income" has been defined by this court as "a gain derived from capital, from labor, or from both combined" (*Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415), "provided it be understood to include profit gained through the sale or conversion of capital assets." (*Eisner* v. *Macomber*, 252 U. S. 189, 207; see also *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509.)

In determining the amount of gain derived from the sale or conversion of a capital asset acquired prior to March 1, 1913, the March 1, 1913, value should be used as a basis only when the March 1, 1913, value is higher than the cost or value at date of acquisition. (*Goodrich* v. *Edwards*, 255 U. S. 527; *Brewster* v. *Walsh*, 255 U. S. 536; *Eldorado Coal & Mining Co.* v. *Mager*, 255 U. S. 522.)

Whether the tax was assessed on the theory that the gain was derived from an *exchange of property* or from a *liquidating dividend*, the *amount* of the tax was the *same* under the Revenue Act of 1916.

A *liquidating* dividend is not in whole a "distribution made or ordered to be made by a corporation * * * out of its earnings or profits" within the definition of the term "dividend" as used in the law (Sec. 10, Part II, Revenue Act of 1916), and the regulations (Art. 106, Regs. 33, Revised), but is a capital transaction, resulting in income to the extent that the amount received by the stockholders exceeds the cost to him of the stock, or the fair market value thereof on March 1, 1913, whichever was higher. (Sec. 2 (c), Revenue Act of 1916; *Goodrich* v. *Edwards*,

255 U. S. 527; *Brewster* v. *Walsh*, 255 U. S. 536; *Cullinan* v. *Walker*, 262 U. S. 134; See also Art. 1548, Regs. 45 (Income Tax).)

The learned counsel for appellant cites the Act of Congress approved Nov. 23, 1921 (42 Stat. ch. 134, Sec. 202 (c) (1) and (2)) to the effect that no tax can accrue on account of gain derived by a stockholder from an exchange of stock or securities incident to the reorganization of a corporation. This, however, recognized that the existing law did tax exchanges of securities in reorganizations; otherwise what was the necessity of the act of 1921?

As stated by counsel in his brief (p. 13), "the language of the Act of 1916, under which this assessment was made, was very general. * * * Section one imposes a tax on *net income received* from all sources. And Section 2 (a) defines net income as 'gains, profits, and income derived from,' among other things, 'sales or dealings in property, whether real or personal.'" That Congress intended to tax such income as should, in fact, be realized through the *exchange* of property is obvious from the language of Section 2 (c): "For the purpose of ascertaining the gain derived from the sale *or other disposition* of property * * *."

There was no such limitation in the 1916 Act with reference to corporate reorganization as that contained in Section 202 (c) (1) and (2) of the Revenue Act of 1921, which is relied upon by counsel for appellant. The change of legislative policy indicated by Section 202 (c) of the 1921 Act only emphasizes

the lack of any such intention in the 1916 Act. If Congress had intended in the 1916 Act not to recognize gain or loss when in the reorganization of one or more corporations a person receives, in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization it could have said so, as it did in the 1921 Act.

That a subsequent amendment is not to be construed as a legislative interpretation of the original Act, under the circumstances of this case, was decided by this court in *United States* v. *Field,* 255 U. S. 257. The situation in the *Field case* was this: The Revenue Act of 1916 did not in express terms include property passed under a power of appointment as part of the gross estate of a decedent for the purpose of computing the estate tax. The Revenue Act of 1918, however, expressly included such property as part of the gross estate. It was argued on behalf of the Government that the 1918 Act was interpretative of the proper construction to be given the 1916 Act. This court in refusing to accept this construction said:

> It would have been easy for Congress to express a purpose to tax property passing under a general power of appointment exercised by the decedent had such a purpose existed; and none was expressed in the Act under consideration. In that of February 24, 1919, which took its place, the section providing how the value of the gross estate of the decedent shall

be determined contains a clause precisely to the point * * *.

Its insertion indicates that Congress at least was doubtful whether the previous Act included property passing by appointment * * *. The Government contends that the amendment was made for the purpose of clarifying rather than extending the law as it stood, and cites a statement to that effect in the report of the House Committee on Ways and Means (House Doc. No. 1287, p. 101, 65th Cong., 2d sess.). It is evident, however, that this statement was based upon the interpretation of the Act of 1916, adopted by the Treasury Decision. The same report proceeded to declare (p. 102) that "the absence of a provision including property transferred by power of appointment makes it possible, by resorting to the creation of such a power to effect two transfers of an estate with the payment of only one tax;" and this, together with the fact that the Committee proposed that the law be amended, shows that the Treasury construction was not treated as a safe reliance. (*United States* v. *Field*, 255 U. S. 257, 264, 265.)

In the case of *Lynch* v. *Hornby*, 247 U. S. 339, it was argued that the Revenue Acts of 1916 and 1917 were declaratory of the meaning of the 1913 Act. In refusing to so hold this court said:

In the more recent Income Tax Acts, provisions have been inserted for the purpose of excluding from the effect of the tax any dividends declared out of earnings or profits that

> accrued prior to March 1, 1913. This originated with the Act of September 8, 1916, and has been continued in the Act of October 3, 1917. We are referred to the legislative history of the Act of 1916, which it is contended indicates that the new definition of the term "dividends" was intended to be declaratory of the meaning of the term as used in the 1913 Act. We can not accept this suggestion, deeming it more reasonable to regard the change as a concession to the equity of stockholders granted in the 1916 Act, in view of constitutional questions that had been raised in this case, in the companion case of *Lynch* v. *Turrish*, and perhaps in other cases * * * (pages 345, 346).

To the same effect was the decision of this court in the case of *Penn Mutual Life Insurance Company* v. *Lederer*, 252 U. S. 523, 535.

VI

From the standpoint of the stockholder, the effect of the transaction was more than a mere reorganization of the same enterprise

It is contended by the appellant that the effect of the so-called reorganization of the business of the General Motors Co. was not to sever any part of the profits of the enterprise; that, looked at as a whole, the purpose and effect of the transaction was to continue the business without a distribution to the stockholders of any part of the property, surplus, or otherwise. This is but another way of saying that looking at the substance of the transaction, the plaintiff

realized no income because after the transaction took place he had nothing he did not have before; that he had merely exchanged one set of certificates for another; that his new stock was but different evidence of his ownership of the same assets or enterprise.

This argument, I wish to point out, involves a total disregard of the intervening corporate entities. It was pressed upon the court with great earnestness and discussed exhaustively in the cases of—

> *Eisner* v. *Macomber*, 252 U. S. 189;
> *United States* v. *Phellis*, 257 U. S. 156;
> *Rockefeller* v. *United States*, 257 U. S. 176;
> *Cullinan* v. *Walker*, 262 U. S. 134;

and discarded by the court as unsound.

The appellant did not merely exchange *certificates* of stock for other *certificates* of stock issued by the same company, but he exchanged *shares* of stock of the New Jersey company for *shares* of stock of the Delaware company, which is quite a different matter. Corporate stocks are property in and of themselves separate and apart from the corporation which issues them. (*Deganey* v. *Lederer*, 250 U. S. 376.)

The new shares were not mere certificates or evidence of ownership of the same assets. The new corporation had a separate and different franchise and charter from the old, with different powers, with an actual or potential good will of its own due to its corporate name, powers, etc., and with a larger capital stock liability. Physical assets do not make a corporation. It takes a charter, a cor-

porate name, stockholders, directors, and much else. Nor do mere physical assets give corporate stock all its value. Its position in the business in which it is engaged, its corporate powers, its record for paying dividends, the character and ability of the men who control it—all of these add to or diminish the value of its stock.

Once to commence disregarding the separate identity of stockholder and corporation would result in hopeless confusion in the interpretaton of the income tax laws, as there would be no logical point at which to stop short of a complete disregard. In this connection permit me to call the court's attention to the following language in the case of *Eisner* v. *Macomber, supra:*

> * * * We must treat the corporation as a substantial entity separate from the stockholder, not only because such is the practical fact, but because it is only by recognizing such separateness that any dividend—even one paid in money or property—can be regarded as income of the stockholder. Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while this would be taxable against the corporation as income under appropriate provisions of law, the individual stockholders could not be separately and additionally taxed with respect to their several shares even when divided, since if there were entire identity between them and the company they could not be regarded as receiving anything from it,

> any more than if one's money were to be removed from one pocket to another. (252 U. S. 189, 213.)

Having due regard to the separate and distinct corporate entities of the New Jersey and Delaware corporations, the transaction was in legal effect the same as though the appellant had sold his stock in the old corporation for cash, or exchanged it for stock of the Standard Oil Company of New Jersey or any other stock having a ready market.

CONCLUSION

Preserve the separate identity of stockholders and corporations, old and new, as among themselves, and give these separate corporate entities their proper force and effect and the case at bar is ruled either by—

> *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509;
> *Goodrich* v. *Edwards*, 255 U. S. 527;
> *Eldorado Coal & Mining Co.* v. *Mager*, 255 U. S. 522;
> *Walsh* v. *Brewster*, 255 U. S. 536;

or by—

> *United States* v. *Phellis*, 257 U. S. 156;
> *Rockefeller* v. *United States*, 257 U. S. 176;
> *Peabody* v. *Eisner*, 247 U. S. 437;
> *Cullinan* v. *Walker*, 262 U. S. 134.

If such a distribution is to be regarded as in the nature of a sale, it is governed by the first group of cases. If it is treated as an ordinary dividend to the extent

that it affects a distribution of surplus, it is ruled by the latter group.

It is therefore submitted that whichever view the court adopts, the judgment of the lower court is [redacted] and should be [redacted]. *affirmed*

JAMES M. BECK,
Solicitor General.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

CHESTER A. GWINN,
Special Attorney, Bureau of Internal Revenue,
Of Counsel.

○

STATEMENT AND ARGUMENT.

STATEMENT OF THE QUESTION TO BE DISCUSSED IN THE BRIEF.

Whether or not there is taxable gain where a new corporation organized to take over the assets of an existing corporation has carried out its purpose and stockholders have received in exchange for every old share several new shares of the same par value as the old and of a market value greater than the cost of the old shares.

ARGUMENT.

a. *Weiss* v. *Stearn*, 44 Sup. Ct. Rep. 491, answers the question No.

b. Taxable gain does not arise from what is *in form* a dividend, an exchange or a sale, unless it is *in substance* also a dividend, an exchange or a sale.

c. Taxable gain does not arise where a stockholder has received additional stock whether in the form of a stock dividend or in the form of stock in a new company organized to take over the assets of the old unless

1. such additional stock represents part of the assets of the old corporation separated from the common fund;

not

2. It has been severed from the property;

may

3. it can be sold by the stockholder to obtain money to pay any income tax assessed on the transaction without altering his pre-existing proportionate interest in the capital of the corporation;

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4. nor if after the stockholder has received it, the original investment of all the stockholders together with accretions and accumulations still remain subject to business risks which may wipe out the entire investment.

d. Until after *Eisner* v. *Macomber,* 252 U. S. 189, the Income Tax Bureau treated the additional shares received in a reorganization as a stock dividend.

e. Its failure to continue to do so has resulted in contradictory and confusing rulings.

f. A rule for determining whether or not taxable income has been received is this: Find out whether or not what has been done could have been done in another way which admittedly would not have produced taxable income. If it could the product is not taxable income. The product is the substance and that is identical. The methods are the forms and they are different.

Under this rule in the case discussed in this brief there is no taxable gain.

TABLE OF CASES.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924.

No. 236.

WILLIAM L. MARR, Appellant, AGAINST UNITED STATES.	Brief submitted with the consent of Court by JAMES BYRNE, ARTHUR A. BALLANTINE, *Amici Curiæ*.

This case is governed by *Weiss* v. *Stearn*, 44 Sup. Ct. Rep. 491, referred to in this brief as the *Acme* case.

I.

In that case stockholders deposited the entire capital stock, $5,000,000, of an existing corporation with a trust company. Bankers deposited $7,500,000 in cash with the same trust company. Representatives of the stockholders and bankers organized a new company. *"Pursuing the definite purpose for which it was organized,* the new corporation purchased and took over the entire property, assets, and business of the old one, assuming all outstanding contracts and liabilities, and in payment therefor issued to the trust company its entire authorized capital stock." The trust company delivered half of the new stock to the bankers and the

other half together with the $7,500,000 cash to the owners of the old stock.

"The collector ruled that each old stockholder sold his entire holding * * * the courts below held that he really sold half for cash and exchanged the remainder, without gain, for the same proportionate interest in the transferred corporate assets and business" (44 Sup. Ct. Rep. 492).

This Court said: "The question for our decision is this: Did they" (the respondents) * * * "dispose with profit of all, or as they maintain, of only half their interests in the National Acme Manufacturing Company within the income provisions, Revenue Act of 1916 C. 463, 39 Stat. 756-757 Section 2 (*a*)" (44 Sup. Ct. Rep. 492).

The only words of Section 2 (*a*) which bear on the case are these:

> "* * * the net income of a taxable person shall include gains, profits and income derived * * * from * * * *sales or dealings in property,* * * * and income derived from any source whatever."

The collector held the exchange of the shares in the old company for shares in the new was a sale or dealing in property. The District Court, the Circuit Court of Appeals and the Supreme Court held it was not.

The Supreme Court held the principles of *Eisner* v. *Macomber,* 252 U. S. 189, were decisive of the *Acme* case. "* * * the essential and controlling fact is that the recipient receives nothing out of the company's assets for his separate use and benefit" (p. 492). Whether the old company had declared a stock dividend of 400 per cent. or had transferred "its entire property and business for the purpose of reorganization" to a new corporation

which gave the old stockholders five new shares for one old share "the capital assets would have remained unimpaired and nothing would have gone therefrom to any stockholder for his separate benefit" (p. 492).

II.

The principles stated in the *Acme* case do more than decide the exact facts of that case. They decide all cases of "reorganization in the technical ownership of an enterprise" "where the ultimate rights in the enterprise" of the stockholders "would have continued substantially as before, the capital assets would have remained unimpaired, and nothing would have gone therefrom to any stockholder for his separate benefit" (p. 492). And "reorganization" we submit "includes", as the Revenue Act of 1921 Section 202 (*c*) (2) says, "recapitalization or mere change in identity, form or place of organization of a corporation (however effected)."

III.

A case cannot be taken out of the principles of the *Acme* case by pointing out differences in fact unless those differences make the principles inapplicable. There are no such differences between the *Acme* case and this case. We shall show this by examining every difference there is of any kind:

(*a*) All the capital stock of the old Acme company was deposited under the written agreement of reorganization mentioned in the opinion of the Court so that the new company was able at once to take over the assets of the old company and issue in payment therefor its entire capital stock.

The written agreement provided for the possibility of some stock not being deposited. The brief of the Government in the *Acme* case says:

> "The provisions contained in subdivision B of paragraph 5 of the agreement is significant. If less than the entire amount of the capital stock of the National Acme Manufacturing Company was deposited, the depositary was to retain ten shares of stock of the new company and $150 in cash on account of each share not deposited until 'adjustment for the purchase of such non-deposited stock under the laws of Ohio or otherwise can be had.' "

In the present case the new company issued its stock for the old as the old stock was deposited with it, and when it had acquired all but a very few shares it then acquired all the property of the old company.

The stockholders in the *Acme* case were fortunate in being unanimous. This enabled them to take the simple and speedy procedure they did. Larger corporations can seldom obtain this unanimity and therefore the reorganization of a solvent company with a large capital is practically always carried out as it was in this case. But the difference of procedure cannot be made into a matter of principle. Nor the fact that owing to the failure of holders of a few hundred shares to come into the reorganization the stock which was set aside for them is sold in order to raise money for corporate purposes.

Nothing of the sort was done here, as we are informed by the General Motors Corporation. The authorized capital stock of the new company was fixed in round numbers at an amount needed to effect an exchange on the agreed terms. The

authorized outstanding capital stock of the old corporation was:

Preferred stock................	$14,985,200
Common stock................	16,511,800

The authorized capital stock of the new corporation was:

Preferred stock................	$20,000,000
Common stock................	82,600,000

To effectuate the exchange on the basis of the letter of October, 1916, would have required stock of the new company as follows:

Preferred stock................	$19,980,300
Common stock................	82,559,000

The stock of the new company actually issued and exchanged for the stock of the old company was:

Preferred stock................	$19,708,400
Common stock................	82,558,000

Many states have statutory provisions by which with the consent of two-thirds or three-fourths of the stockholders the corporation may sell to a new corporation all its assets for cash or for stock of the new corporation with the right on the part of the non-assenting stockholders to have their shares appraised and the cash value paid to them either by the old company or the purchasing company. Suppose in the *Acme* case some of the shareholders had refused to consent and resort was had to such a statutory provision. Would not the decision of this Court have been exactly the same as it was in the *Acme* case? Reorganizations in different states and in different circumstances will have varied forms.

(*b*) In the *Acme* case stock was deposited with a trust company under an agreement the purpose of which was to keep it together until the new company was formed and acquired the assets of the old. In the present case, as only 70% of the stockholders had agreed to the plan before the letter of October 16, 1916, was sent out to all the stockholders the new company was formed at once and issued its stock to the old stockholders as fast as they deposited their old stock with it; the intention being to acquire practically all of the stock of the old company and then to acquire all its property. The new company was not a holding company. It, like the old company, was an automobile company with a right to hold stock of other companies.

The case of *Cullinan* v. *Walker,* 252 U. S. 134, has no application here. As the Court in the *Acme* case said in disposing of the *Cullinan* case:

> "Cullinan's gain resulted from a dividend in liquidation actually distributed in the stock of a holding company incorporated under the laws of a foreign state, not organized for the purpose of carrying on the old business and which held no title to the original assets."

In the present case the new company *was* organized for the purpose of carrying on the old business and it *did* acquire title to the original assets. In the language of the *Acme* case already quoted *"pursuing the definite purpose for which it was organized* the new corporation purchased and took over the entire property, assets and business of the old one." The whole scheme in the present case was to have a company which should carry on the old business and acquire title to the original assets. The Court below found as a fact (Finding IV (2)): "In 1916 the officers of the New Jersey corporation caused

the Delaware corporation to be organized for the purpose of taking over and continuing the business of the New Jersey corporation." The whole scheme in the *Cullinan* case was to have a company which should *not* carry on the old business, not even have power to do so, and should *not* acquire title to the original assets. The petition of Cullinan said as appears in the record in that case that the new company was formed "to exist in the capacity solely of a holding company" and the petition gave the reason why the new company was not to hold the title to the original assets in stating that the old company did both a producing and a pipe line business and its officers were advised by counsel that under the laws of Texas a single corporation could not combine under one charter those two businesses. The purpose of the new company in the *Cullinan* case was to be a holding company and nothing else. In the present case the new company, though like the old company it had power to hold shares of stock, was like the old company a company organized to manufacture and sell automobiles.

The real question always is what was the purpose for which the new company was organized, has it pursued and accomplished that purpose? And where the purpose is to have a new corporation which shall acquire the assets of the old and that purpose is pursued and accomplished, there has been no change in substance but one in form, and the details of how it is brought about are of no importance. Thus in the *Acme* case it was brought about, as the record shows, by an agreement which in form was a sale by the stockholders to the bankers. We quote the pertinent part of the agreement from the record page 10 of the *Acme* case:

> "The Vendors" (the stockholders) "agree to and will sell all their said shares of common

> capital stock to, and the Purchasers" (the bankers) "agree to and will purchase the same from them, as well as any and all shares of the common capital stock of said The National Acme Manufacturing Company, the holders of which deposit the same with the depositary hereinafter named, *subject to the terms of this agreement,* at and for the price of Three Hundred Dollars ($300.00) per share, payable, one half in cash and one half in securities, *as hereinafter set forth;*" (Record, p. 10).

This was in form a sale to the bankers. The new company was not a party to it; but the Court considered it but a step in the reorganization and construed it as being a sale of only half of the Vendors' stock and an exchange of the other half for the stock of the new company.

Article 1563 of Regulation 45 of the Treasury Department provided:

> "Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (*a*) that is *essentially different* from the property disposed of and (*b*) that has a market value. In other words, both (*a*) a change in substance and not merely in form, and (*b*) a change into the equivalent of cash, are required to complete or close a transaction from which income may be realized. *By way of illustration, if a man owning ten shares of listed stock exchanges his stock certificate, no income is realized, because the conversion is merely in form.*"

The new corporation was organized for the same purposes for which the old company had existed; it owned precisely the same property and assets; it was conducted under the same management; it

consisted of the same stockholders; it, in fact, carried on the same business. How is it possible that, these facts being admittedly true, it can be considered that one enterprise differed in substance from the other? And inasmuch as all of the stock of the new corporation continued to represent all of the property of the old, just as all of the stock of the old represented the same property, no more and no less, it is plain not merely that there was an identity of enterprises, but that nothing had been subtracted from the earnings or capital of the old company and had been given to its stockholders and therefore that there was nothing that could be deemed income.

(*c*) In the *Acme* case the old company and the new company were both organized under the laws of Ohio. In the present case the old company was organized under the laws of New Jersey and the new company under the laws of Delaware. In the extract which we have just given from the *Acme* case the fact is stated that in the *Cullinan* case the new company was incorporated under the laws of a foreign state. But the opinion is not based upon that fact. For it is impossible to base upon it a distinction in principle. The whole reasoning of the opinion would be just as applicable if the new company in the *Acme* case had been organized under the laws of a foreign state. "The value of the stockholders' holdings would not have changed", "the capital assets would have remained unimpaired", "nothing would have gone therefrom to any stockholder for his separate benefit", and "the entire arrangement" would have "amounted to a financial reorganization under which each old stockholder retained half of his interest and disposed of the remainder" (44 Sup. Ct. Rep. 491-2). The question of whether a transaction is a reorganiza-

tion or not does not in the mind of anyone, courts, legislators, lawyers or business men depend upon whether the new corporation is organized under the same state as the old or under a foreign state. No such distinction has ever been taken in Congress, in the Income Tax Bureau or in the decisions of this Court.

(*a*) Congress said in the Revenue Act of 1921 that reorganization includes "recapitalization or mere change in identity, form or place of organization of a corporation (however effected)."

(*b*) The Income Tax Bureau has never made the question of whether or not there was a real sale or there was taxable gain depend upon whether the new corporation was a foreign or domestic one. In A. R. R. 16 (3-20-697), June, 1920; Cumulative Bulletin, page 312, *a corporation reincorporated in another state* and stock of the old corporation was exchanged for stock of the new, share for share of equal par value. The Committee said: "The change of domicile took place in 1916, and the Committee has considered a number of precedents established under the acts of 1913 and 1916, with regard to the treatment of essentially similar transactions * * * *It also finds that in numerous cases it was held that no income accrued to the stockholders by reason of exchange of their stock in the old for stock in the new corporation.*"

(*c*) This court has twice decided in income tax cases, *Southern Pacific Co.* v. *Low*, 247 U. S. 330, and *Gulf Oil Corporation* v. *Llewellyn*, 248 U. S. 71 (cited as authorities in the *Acme* case) that corporations (which were organized under the laws of different States), while "distinct beings in contemplation of law", were in substance identical. In the

first case, the Southern Pacific Company, a corporation of Kentucky, owned all the capital stock of the Central Pacific, a corporation of the State of Utah. The Utah corporation declared a dividend, but the court held that though the two companies were separate legal entities they were in fact merged and therefore the thing which was a dividend in form, in substance was not. The same thing was held in *Gulf Oil Corporation* v. *Llewellyn*, 248 U. S. 71. The District Court had found (245 Fed. Rep. 1, pp. 2-3) that the Gulf Oil Corporation was a holding company of New Jersey and that it was the owner of all the capital stock except directors' qualifying shares of the J. M. Guffey Petroleum Company, the Gulf Pipe Line Company, the Gulf Pipe Line Company of Oklahoma and the Indiana Oil & Gas Company. As a matter of fact the subsidiary companies were none of them corporations of the same state as the holding company, as was quite apparent from the names of some of them. The subsidiary companies declared dividends which were paid to the holding company not in cash but by taking over debtor and creditor accounts existing among the subsidiary corporations. The Circuit Court of Appeals said, page 6:

> "* * * each of the companies, whether holding or subsidiary, is a distinct entity and is to be so treated. The several companies are not in such relations to each other that the property and obligations and liabilities of one can be regarded as the property and obligations and liabilities of any other. Each owns its own assets, carries on its own business, owes its own debt, pays its own taxes and enjoys its own income."

It followed, therefore, in the opinion of that court, that a dividend had been declared by the sub-

sidiaries, that it had been received by a corporation which was a distinct entity and therefore the corporation receiving the dividend had received taxable income. The Supreme Court reversed this ruling and held that though in contemplation of law the subsidiaries were distinct beings from the petitioner the forms gone through should be disregarded and the dividends not considered as income. In other words, although corporations are, to use the language of Mr. Justice Holmes in the *Gulf Oil Company* case, "distinct beings in contemplation of law", they may be in substance the same, and that, too, whether they are corporations of the same or different states. In other words there may be such a relationship between corporations of the same or different states that what is in form a dividend is in substance not. On the same principle there can be such a relationship between corporations whether of the same or different states that what in form is a sale or exchange of stock in substance is not.

IV.

The theories and practice and rulings of the Income Tax Bureau in cases of reorganization have been for years contradictory and confusing. This is because the Bureau refused to follow in all cases of reorganization the principles of the stock dividend decisions.

We have three periods in the practice of the Bureau:

> (*a*) A period when the Bureau held taxable gain did not arise from a stock dividend or from a reorganization;

(*b*) a period when it held taxable gain did arise from a stock dividend and held as a consequence that taxable gain did arise from a reorganization.

Then came *Towne* v. *Eisner*, 245 U. S. 418 (Jan. 7, 1918), and *Eisner* v. *Macomber* (March 8, 1920) and in consequence

(*c*) a period when the Bureau held that no taxable gain arose from a stock dividend. To be logical and consistent the Bureau in period (*c*) should have held and should now hold that no taxable gain arises from a reorganization. This the Bureau in some cases does and in others does not.

It makes a distinction between the case where the exchange is share for share and where the exchange is one share for several shares. It says that when A receives for one share of stock which cost him $30 five shares of stock in a new company of a market value of $600 (whether the new company is foreign or domestic), A makes $570 profit, but when B on the same day receives for one share of stock in an old company which cost him $30 *one* share of stock of a new company of a market value of $600, he makes no profit (whether the new company is foreign or domestic).

Such a distinction, we submit, is entirely without reason. But it will continue to be taken by the Bureau until this case is decided in favor of the appellant.

V.

A rule to decide whether any transaction is a change, not in substance but only in form, may be found, we suggest, in this:

To determine whether or not in any case taxable income has been received, find out whether what has been done could have been done in another way, which admittedly would not have produced taxable income. In other words if there are two methods of producing one thing from another and the product in one case is not taxable it is not taxable in the other. The product is the substance and that is identical. The method is the form and that is different.

What we start with is a company having a certain amount of common stock; what we come out with is a company having five times that amount of common stock, each holder of one share of stock in the old company ending up with five shares of stock of the new company, and the new company having the assets of the old company.

Is there any way in which this result might have been obtained so that under the decisions of the Supreme Court and the rulings of the income tax office the stockholder does not receive taxable income? Yes, as follows:

(1) The old company could have declared a stock dividend of four hundred per cent.; each holder of one share would thereafter have been the holder of five shares of the old company. There would have been no taxable income. *Eisner* v. *Macomber*.

(2) The holders of the stock of the old company could then have exchanged their stock share for share for stock of the new company without

having received taxable income. A. R. R. 16 (3-20-697), June, 1920, Cumulative Bulletin, page 312.

Another method:

(1) The old corporation could have exchanged its stock, share for share, for the stock of the new corporation.

(2) The new corporation could then have declared a stock dividend. *Eisner* v. *Macomber*.

VI.

So far, in order to present the question clearly, we have left the question of preferred stock out of the case altogether and have assumed that both the old and the new company had nothing but common stock and there was merely an exchange of stock of the old company and stock of the new company at the rate of one share for five.

The facts are that the old company had 7% preferred stock and the new company 6% preferred stock and the old preferred was exchanged for the new at the rate of three shares for four.

This does not alter the fact at all that there was not a sale but a readjustment of the interests of the parties. The only effect is that the common stockholder has given up some slight interest in the assets. In other words he has *lost* something by the exchange, not *gained* anything.

We must look at the substance not the form of the transaction. Suppose no new company had been formed, but that all the stockholders of the old company had agreed that the rights of the parties should be readjusted and that each preferred stockholder should receive four shares of preferred 6% stock for every three shares of

preferred 7% stock that he had previously owned. Surely whatever may have been the case with the preferred stockholder, there could be no claim that by such a readjustment of interest the common stockholder had realized any income. Let it be assumed that the four shares of 6% preferred stock were more valuable than the three shares of the 7% preferred and that therefore the preferred shareholders had made something which should be taxable. There was nothing gained by the common stockholder who had simply retained his shares and therefore nothing on which he could be taxed. Apply the test which we have already referred to of what is a matter of form as distinguished from a matter of substance. It is certain that the following procedure could have been taken without any taxable income being realized.

(1) The charter of the old company could have been amended so as to allow four shares of new 6% to be given for three shares of old 7%, and the exchange could have been made.

(2) A stock dividend could have been declared of 400% by the old company and each holder of a share of stock of the old company would have become the holder of five shares of stock of that company; no taxable income. *Eisner* v. *Macomber*.

(3) The shares of the old company could have been exchanged dollar for dollar for shares of the new company; no taxable income.

LAST POINT.

The result of the *Acme* case is not merely that under the facts of that case within the meaning of the Revenue Act of 1916 there was no income, but that any act saying there was would be unconstitutional. The court says that it adopts the ruling of the courts below that each old stockholder sold half of his stock for cash "and exchanged the remainder *without gain* for the same proportionate interest in the transferred corporate assets and business". If there was not gain any act attempting to say there was gain and taxing it would be unconstitutional. "* * * when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form." "* * * We cannot conclude that mere change for purposes of reorganization in the technical ownership of an enterprise under circumstances like those here disclosed followed by issuance of new certificates constitutes gain separated from the original capital interest. Something more is necessary—something which gives the stockholder a thing really different from what he theretofore had."

Respectfully submitted,

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Amici Curiæ.